

**AGENDA – March 28, 2001 Business Taxes Committee Meeting**  
**Proposed Amendments to Regulation 1705.1, *Innocent Spouse Relief of Liability***

<p><b>Action 1 – Consent</b></p> <p>Amended Regulation 1705.1, <i>Innocent Spouse Relief of Liability</i>  Exhibit 2, pages 1-3:</p>	<p>Adopt language proposed by staff. No objections have been raised by interested parties.</p> <ol style="list-style-type: none"> <li>1. Incorporate minor technical changes.</li> <li>2. Add provision to subdivision 1705.1(c) to clarify that disregard of community property laws applies only to a claiming spouse no longer married to, legally separated from, or no longer part of the household of the nonclaiming spouse.</li> <li>3. Add subdivision 1705.1(h) to provide guidelines for the administration and consideration of equitable relief claims.</li> <li>4. Add subdivision 1705.1(i) to clarify that a nonclaiming spouse is to be notified about a claim and the basis for the claim.</li> </ol>
<p><b>Action 2 – Authorization to Publish</b></p>	<p>Direct the publication of the proposed amendments to Regulation 1705.1 as adopted in the above actions.</p> <p>Operative Date: Subdivision 1705.1(h) has an operative date of January 1, 2001. There are no operative dates for the other amendments.</p> <p>Implementation: Implementation will take place 30 days following approval by the Office of Administrative Law</p>

**AGENDA – March 28, 2001 Business Taxes Committee Meeting**  
**Proposed Amendments to Regulation 1705.1, *Innocent Spouse Relief of Liability***

**ACTION 1 – Consent Item**

Item	Language Proposed by Staff
1. Incorporate minor technical change.	<p>(a) <b>IN GENERAL.</b> A spouse claiming relief from liability for any sales or use tax, interest, penalties, and other amounts shall be relieved from such liability where all the following requirements are met:</p> <p>(1) A liability is incurred under the Sales and Use Tax Law;</p> <p>(2) The liability is attributable to the nonclaiming spouse;</p> <p>(3) The spouse claiming relief establishes that he or she did not know of, and that a reasonably prudent person in the claiming spouse's circumstances would not have had reason to know of, the liability; and</p> <p>(4) It would be inequitable to hold the claiming spouse liable for the liability, taking into account whether the claiming spouse significantly benefited directly or indirectly from the liability, and taking into account all other facts and circumstances.</p> <p>(b) <del>DEFINITION OF "BENEFITED."</del> Whether a claiming spouse has benefited directly or indirectly from the liability will be determined by a review by the <u>B</u>oard of all of the available evidence. Normal support payment is not a significant benefit for purposes of this determination. Normal support is measured relative to each family's standard of living. The claiming spouse will not be deemed to have benefited directly or indirectly from the liability solely as a result of normal support unless his or her lifestyle significantly improved during the periods of liability. Gifts received by the claiming spouse, or lavish or luxury purchases made by either spouse may be evidence that the claiming spouse benefited directly or indirectly from the liability. Evidence of direct or indirect benefit may consist of transfers of property, including transfers which may be received several years after the calendar quarter in which the liability occurred. For example, if a claiming spouse receives from the other spouse an inheritance of property or life insurance proceeds which are traceable to the liability, the claiming spouse will be considered to have benefited from that liability. Other factors considered may include desertion of the claiming spouse by the other spouse or that the spouses have become divorced or separated subsequent to the periods of liability.</p>

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Item	Language Proposed by Staff
<p>2. Add provision to subdivision 1705.1(c) to clarify that disregard of community property laws applies only to a claiming spouse no longer married to, legally separated from, or no longer part of the household of the nonclaiming spouse.</p>	<p>(c) <b>ATTRIBUTION</b> The determination of the spouse to whom items of liability are attributable shall be made without regard to community property laws.</p> <p><u>(1) A claim may be filed if, at the time relief is requested, the claiming spouse is no longer married to or is legally separated from the nonclaiming spouse, or the claiming spouse is no longer a member of the same household as the nonclaiming spouse.</u></p> <p><u>(2)</u> With respect to a liability incurred as a result of a failure to file a return or an omission of an item from the return, attribution to one spouse may be determined by whether a spouse rendered substantial services as a retailer of taxable items related to the liability. If neither spouse rendered substantial services as a retailer, then the attribution of the liability shall be treated as community property. A liability incurred as a result of an erroneous deduction or credit shall be attributable to the spouse who caused that deduction or credit to be entered on the return.</p> <p>(d) <b>WRITTEN REQUEST FOR RELIEF.</b> To seek relief under these provisions, a claiming spouse may submit a written request for relief setting forth the seller's permit number, the period for which relief is requested, and the specific grounds upon which the request for relief is based.</p> <p>(e) <b>STATUTE OF LIMITATIONS.</b> These provisions shall apply to all calendar quarters for claims made no later than one year after the board's first contact with the spouse making the claim.</p> <p>Claims made after one year from the board's first contact with the spouse making the claim shall not apply to any calendar quarter that is more than,</p> <p style="padding-left: 40px;">Five years from the return due date for nonpayment on a return, or</p> <p style="padding-left: 40px;">Five years from the finality date on the board-issued determination,</p> <p>whichever is later.</p> <p>No calendar quarters shall be eligible for relief under this regulation that have been closed by res judicata.</p>

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Item	Language Proposed by Staff
<p>3. Add subdivision 1705.1(h) to provide guidelines for the administration and consideration of equitable relief claims.</p>	<p>(f) <b>REFUNDS.</b> A refund of any amounts under these provisions shall be subject to the requirements as set forth in Revenue and Taxation Code sections 6901 through 6908, inclusive.</p> <p>(g) This regulation shall apply retroactively to liabilities arising prior to January 1, 1994.</p> <p>(h) <u>Effective January 1, 2001, a spouse may be relieved of liability for any unpaid tax or deficiency under the Sales and Use Tax Law if, taking into account all the facts and circumstances, it is inequitable to hold the spouse liable for such amount attributable to any item for which relief is not available under subdivisions (a) through (d). A spouse may be considered for equitable relief under this subdivision only after a written claim for relief as an innocent spouse has been filed pursuant to subdivision (d). A spouse whose claim for equitable relief is denied may request that the claim be reconsidered by the Board.</u></p> <p><u>(1) Criteria for Equitable Relief.</u></p> <p><u>(A) Factors that may be considered for the purpose of granting equitable relief include, but are not limited to:</u></p> <p><u>1. The claiming spouse is separated (whether legally or not) or divorced from the nonclaiming spouse.</u></p> <p><u>2. The claiming spouse would suffer economic hardship if relief is not granted.</u></p> <p><u>3. The claiming spouse, under duress from the nonclaiming spouse, did not pay the liability. To substantiate “duress,” the claimant spouse must provide objective evidence. “Objective evidence” can include, but is not limited to, such documents as police reports, restraining orders, or counseling reports.</u></p> <p><u>4. The claiming spouse did not know and had no reason to know about the items causing the understatement or that the tax would not be paid.</u></p> <p><u>5. The nonclaiming spouse has a legal obligation under a divorce decree or agreement to pay the tax. (This obligation will <b>not</b> be considered a positive factor if the claiming spouse knew or had reason to know, at the time the divorce decree or agreement was entered into, that the nonclaiming spouse would not pay the tax.)</u></p>

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**Proposed Amendments to Regulation 1705.1, *Innocent Spouse Relief of Liability***

Item	Language Proposed by Staff
<p>4. Add subdivision 1705.1(i) to clarify that a nonclaiming spouse is to be notified about a claim and the basis for the claim.</p>	<p><u>6. The tax for which the claiming spouse is requesting relief is attributable to the nonclaiming spouse.</u></p> <p><b>(B)</b> Factors that may be considered for purposes of denying equitable relief include, but are not limited to:</p> <p><u>1. The claiming spouse will not suffer economic hardship if relief is not granted.</u></p> <p><u>2. The claiming spouse knew or had reason to know about the items causing the understatement or that the tax would be unpaid at the time the claiming spouse signed the return.</u></p> <p><u>3. The claiming spouse received a significant benefit from the unpaid tax or items causing the understatement.</u></p> <p><u>4. The claiming spouse has not made a good faith effort to comply with the Board's laws for the periods for which the claiming spouse is requesting relief or for subsequent periods of liability.</u></p> <p><u>5. The claiming spouse has a legal obligation under a divorce decree or agreement to pay the tax.</u></p> <p><u>6. The tax for which relief is being requested is attributable to the claiming spouse.</u></p> <p><u>(2) Conditions for Relief. The following conditions apply to claims for equitable relief:</u></p> <p><u><b>(A)</b> The statutes of limitations provided for innocent spouse claims in subdivisions 1705.1(e) and (f) also apply to requests for equitable relief.</u></p> <p><u><b>(B)</b> Claims for equitable relief are not limited to liabilities incurred after the effective date of January 1, 2001, but are allowed the same retroactivity as granted in subdivision (g) for a claim as innocent spouse.</u></p> <p><u><b>(i)</b> Notification of the claim for relief from liability and the basis for that claim shall be sent to the non-claimant spouse.</u></p>

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- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

## **Proposed Regulatory Changes Concerning the Granting of Equitable Relief to a Spouse Under Regulation 1705.1, Innocent Spouse Relief from Liability**

### **I. Issue**

Should Regulation 1705.1, *Innocent Spouse Relief from Liability*, be amended to 1) add provisions concerning procedures for granting equitable relief for spouses as provided by AB 2898, 2) clarify that a claim may be filed if, at the time relief is requested, the claiming spouse is no longer married to or is legally separated from the nonclaiming spouse, or is no longer a member of the same household as the nonclaiming spouse, and 3) add provisions that require notification be sent to the non-claiming spouse about innocent spouse or equitable relief claims and the basis for those claims?

### **II. Staff Recommendation**

To implement Revenue and Taxation Code (RTC) subdivision 6456(f), staff recommends that subdivision (h) be added to Sales and Use Tax Regulation 1705.1 to provide for the conditions and procedures under which a claiming spouse who is denied relief as an innocent spouse may apply for equitable relief. Subdivision has an operative date of January 1, 2001.

Staff recommends that, in conformity with the California Personal Income Tax Law and the federal Internal Revenue Code, language be added to subdivision 1705.1(c) to clarify that an innocent spouse claim may be filed when the claiming spouse is no longer married to, is legally separated from, or is no longer a member of the same household as the nonclaiming spouse. This provision has no operative date.

Staff also recommends that, in conformity with California Personal Income Tax Law, subdivision 1705.1(i) be added to the regulation requiring notification of the non-claiming spouse about a claim for innocent spouse relief or equitable relief and the basis of the claim. This provision has no operative date.

### **III. Other Alternative(s) Considered**

Do not amend Regulation 1705.1.

## **IV. Background**

Regulation 1705.1 (Exhibit 2), effective December 5, 1997, interprets and explains the provisions of RTC section 6456 (Exhibit 3). Section 6456 provides relief to innocent spouses from liabilities incurred under the Sales and Use Tax Law, using provisions similar to those in the Internal Revenue (IRS) Code and the Personal Income Tax Law (FTB Code).

Section 6456 was amended by AB 2898, Stats. 2000, Ch. 1052, which added subdivision (f) to section 6456, effective January 1, 2001. Subdivision (f) provides:<sup>1</sup>

Under procedures prescribed by the board, if, taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for any unpaid tax or any deficiency (or any portion of either) attributable to any item for which relief is not available under subdivision (a), the board may relieve the other spouse of that liability.

This provision was added to section 6456 to conform the statute to similar provisions in the FTB and IRS codes concerning equitable relief. Regulation 1705.1 currently addresses all subdivisions of section 6456 except (f).

The relief from liability provided to a spouse by section 6456 applies to a limited class of taxpayers. The spouse's liability must result from the activities of a business co-owned by both spouses, or from a dual determination issued because the spouse had been active in a sole proprietorship operated by the other spouse. In general, a taxpayer who has a liability resulting from the activities of a corporation or non-spouse partnership is not eligible for innocent spouse relief.

Regulation 1705.1(a) provides specific criteria for a claiming spouse's eligibility. These criteria are:

- The liability must have been incurred under the Sales and Use Tax Law.
- The liability is attributable to the non-claiming spouse. "Attribution" is described in subdivision (c) and is determined on the basis of which spouse rendered substantial services as a retailer or, if an erroneous deduction or credit is claimed, which spouse caused the deduction or credit to be entered on the return. If individual attribution cannot be established, then both spouses are held to be the retailers.
- The claiming spouse did not know of the liability and a reasonably prudent person in the claiming spouse's position would not have reason to know.
- It would be inequitable to hold the claiming spouse liable when taking into account the significant direct or indirect benefit to the claiming spouse and taking into account all other facts and circumstances. "Significant benefit," discussed in subdivision 1705.1(b), does not include support payments that allow the spouse to maintain a normal standard of living.

Subdivision 1705.1(d) provides that a claiming spouse must submit the request for relief in writing. The written request must include the seller's permit number, the period for which relief is requested, and the specific grounds on which the claim is based.

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<sup>1</sup> Section 6456 was enacted by AB 1288, Stats. 1993, Ch. 181. It was subsequently amended by SB 1827, Stats. 1996, Ch. 1087.

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Subdivisions 1705.1(e) and (f) provide for statutes of limitations on innocent spouse claims. The statute of limitations under subdivision 1705(e) applies to claims filed on liabilities not yet paid. The statute of limitations in subdivision 1705.1(f) applies to innocent spouse claims on liabilities already paid. These claims are subject to the provisions of RTC sections 6901 through 6908.

Administratively, requests for relief as an innocent spouse are filed with the Board's Offers in Compromise Section (OIC). If the OIC's initial review finds that the claim is timely, the OIC will determine whether the claim meets the substantive criteria of attribution, benefit, and knowledge. The OIC makes this determination based on the explanation included in the claim and the documentation provided by the claiming spouse. In general, the claiming spouse must document that:

- The underpayment is attributable to the other spouse. This includes underpayments from a failure to file a return, the understatement of amounts reported, or an erroneous claim of a credit or deduction.
- The claiming spouse received no significant benefit because of the underpayment.
- The claiming spouse had no knowledge of the underpayment.

Because each case is unique, there are no standard types of documentation. In general, the information submitted by the claiming spouse must demonstrate that, during the period of the liability, the claiming spouse:

- Had no direct involvement with the business, such as being included on the business checking account, keeping the books, signing checks, managing employees, or signing returns.
- Had separate assets, such as wages, bank accounts, or real property; or maintained a separate household because of separation or divorce.
- Filed separate federal and state income tax returns in which the claiming spouse took no depreciation for the business assets and showed no income or loss from the business.

The claiming spouse must also document that there were no subsequent joint bankruptcy filings that included the liability and that any support received from the other spouse during the period of liability helped only to maintain a "normal" lifestyle.

The documentation that a claiming spouse may provide in support of his or her position is not restricted to the items listed above. A claiming spouse may provide any documentation that will help support the claim of innocent spouse status.

Subdivision 1705.1(a) provides that all requirements must be met. Failure to adequately document any one requirement: attribution, lack of knowledge, or lack of significant benefit, will result in denial of the request. Until the enactment of subdivision 6456(f), a claiming spouse whose request for innocent spouse relief had been denied had no further recourse for relief of the liability under RTC section 6456.

## **V. Staff Recommendation**

### **A. Description of the Staff Recommendation**

To implement Revenue and Taxation Code (RTC) subdivision 6456(f), staff recommends that subdivision (h) be added to Sales and Use Tax Regulation 1705.1 to provide for the conditions and procedures under



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which a claiming spouse who is denied relief as an innocent spouse may apply for equitable relief. Subdivision has an operative date of January 1, 2001.

Staff recommends that, in conformity with the California Personal Income Tax Law and the federal Internal Revenue Code, language be added to subdivision 1705.1(c) to clarify that an innocent spouse claim may be filed when the claiming spouse is no longer married to, is legally separated from, or is no longer a member of the same household as the nonclaiming spouse. This provision has no operative date.

Staff also recommends that, in conformity with California Personal Income Tax Law, subdivision 1705.1(i) be added to the regulation requiring notification of the non-claiming spouse about a claim for innocent spouse relief or equitable relief and the basis of the claim. This provision has no operative date.

Equitable Relief

Subdivision (f) of RTC section 6456 authorizes the Board to grant equitable relief to a claiming spouse who does not meet the strict criteria of the innocent spouse provisions in RTC section 6456 and Regulation 1705.1. Under the provisions of subdivision 6456(f), staff must consider all facts and circumstances presented by the claiming spouse. If, on balance, it appears inequitable to hold the claiming spouse liable, staff may recommend relief of the liability.

Staff is of the opinion that the following conditions apply to claims for equitable relief:

- A claim for equitable relief may be considered only after a taxpayer has filed a claim for relief as an innocent spouse. This recommendation is based on the language of 6456(f), which provides that equitable relief should be considered for “any item for which relief is not available under subdivision (a),” that is, under the innocent spouse provision of section 6456. In staff’s opinion, this language requires that a spouse must first apply for innocent spouse relief before he or she can be considered for equitable relief.
- The statute of limitations provided for in subdivision 1705.1(e) also applies to requests for equitable relief. This opinion is based on the language in subdivision 6456(f). This subdivision provides that equitable relief may apply only if relief is not available under 6456(a), that is, the innocent spouse provisions. Subdivision 6456(f) does not exclude equitable relief from the statute of limitations for innocent spouse relief provided for in subdivision 6456(c).
- Equitable relief claims shall apply retroactively to liabilities that have arisen prior to January 1, 1994, as provided in subdivision 1705.1(g). That is, claims for equitable relief are not limited to liabilities incurred after the effective date of January 1, 2001, but are allowed the same retroactivity as granted to innocent spouse claims.

Staff proposes that the following administrative procedures be adopted:

- OIC staff will concurrently review all claims for both the innocent spouse and equitable relief. This procedure will alleviate the need for claiming spouses to submit separate claims.
- A claiming spouse who has been denied equitable relief may request reconsideration by the Board Members. The claiming spouse will be informed of this procedure in a letter informing him or her of the denial. The ability to request reconsideration is stated in subdivision 1705.1(h). Staff will consult with the Board Members and Board Proceedings on how to best implement the procedure.

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OIC staff is developing criteria that will be used to evaluate claims for equitable relief. These criteria will be similar to criteria used by the Franchise Tax Board to evaluate equitable relief claims under the Personal Income Tax Law. Factors that may be considered for purposes of granting equitable relief include, but are not limited to:

- The claiming spouse is separated (whether legally or not) or divorced from the nonclaiming spouse.
- The claiming spouse would suffer economic hardship if relief is not granted.
- The claiming spouse, under duress from the non-claiming spouse, did not pay the liability. To substantiate “duress” the claiming spouse must provide objective evidence. “Objective evidence” can include, but is not limited to such documents as police reports, restraining orders, or counseling reports.
- The claiming spouse did not know and had no reason to know about the items causing the understatement or that the tax would not be paid.
- The nonclaiming spouse has a legal obligation under a divorce decree or agreement to pay the tax. (This obligation will **not** be considered a positive factor if the claiming spouse knew or had reason to know, at the time the divorce decree or agreement was entered into, that the nonclaiming spouse would not pay the tax.)
- The tax for which the claiming spouse is requesting relief is attributable to the non-claiming spouse.

Factors that may be considered for purposes of denying equitable relief include, but are not limited to:

- The claiming spouse will not suffer economic hardship if relief is not granted.
- The claiming spouse knew or had reason to know about the items causing the understatement or that the tax would be unpaid at the time the claiming spouse signed the return.
- The claiming spouse received a significant benefit from the unpaid tax or items causing the understatement.
- The claiming spouse has not made a good faith effort to comply with the Sales and Use Tax Law for the periods for which the claiming spouse is requesting relief or for subsequent periods of liability.
- The claiming spouse has a legal obligation under a divorce decree or agreement to pay the tax.
- The tax for which relief is being requested is attributable to the claiming spouse.

#### Clarification of Status for a Spouse Still Married To and Living With the Other Spouse

A key factor in determining eligibility as an innocent spouse is whether the liability is “attributable” to the other spouse. That is, there is a finding by the Board that the other spouse is wholly responsible for the sales or use tax liability. Subdivision 6456(b) provides that this finding “shall be made without regard to community property laws.” That is, the responsibility for the liability is determined against one spouse even though, under community property laws, the spouses would normally be jointly liable. Subdivision 6456(e) provides that a liability may be determined to be “attributable to one spouse” when a spouse renders substantial services as a retailer. If neither spouse renders substantial services as a retailer, the

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attribution of applicable understatements will be treated as community property. That is, both spouses will be liable.

Subdivision 1705.1(c) restates the “attribution” provisions of 6456. Although the current language of this subdivision is an accurate paraphrase of the statute, staff is of the opinion that it does not, as stated in Regulation 1500, *Foreword*, sufficiently “implement, interpret or make specific” the “attribution” provisions of RTC section 6456. In particular, the regulation does not make clear how one is to apply the provision “without regard to community property laws” in subdivision 6456(b). It has been suggested that this language should be interpreted to provide innocent spouse relief from a sales and use tax liability that qualifies as a community debt when a spouse is still married to and living with the other spouse.

The community property law statutes are in the California Family Code. In general, these statutes provide that property owned by a husband and wife is owned in common. That is, the property qualifies as community property. Community property includes not only assets, but also wages earned by either spouse. In addition, a spouse is generally liable for any debt generated by either spouse. That is, the debt qualifies as community debt. Community debt includes, but is not limited to, mortgages, consumer debt, and tax liabilities. A creditor can collect community debt through a levy of property owned by the couple, including the wages earned by either spouse. The only exception is property that was owned prior to the marriage by either spouse or property that is protected by a pre-nuptial agreement.

Staff is of the opinion that the language “without regard to community property laws” was never intended to relieve a spouse who is still married to and living with the other spouse from his or her responsibility for community debt. The innocent spouse provisions in the Sales and Use Tax Law are modeled on and were intended to conform, as closely as possible, to like provisions in the IRS and California Personal Income Tax (FTB) codes. Both the federal and state income tax codes contain the phrase that “any determination under this section shall be made without regard to community property laws.” Similar language was incorporated into RTC section 6456. Both the federal and state income tax codes also restrict eligibility for claims for relief to individuals who are no longer married to, are legally separated from, or are no longer a member of the same household as the nonclaiming spouse (United States Tax Code 6015(c)(3)(i) and Personal Income Tax Law 18533(c)(3)(i)). The restrictions on eligibility are summarized in IRS Revenue Procedure 2000-15, subdivision 4(.02)(1)(a), which provides the following criterion for granting a claim:

At the time relief is requested, the requesting spouse is no longer married to, or is legally separated from, the nonrequesting spouse, or has not been a member of the same household as the nonrequesting spouse at any time during the 12-month period ending on the date relief was requested.

The amendment recommended by staff to subdivision 1705.1(c) will clearly indicate that, in conformity with the IRS and FTB codes and published procedures, innocent spouse relief under the Sales and Use Tax Law is generally limited to those who are no longer married to, are legally separated from, or living apart from the other spouse.

Notification

The requirement that staff notify a non-claiming spouse about a claim and the basis of the claim is recommended because it more closely conforms the Board’s innocent spouse and equitable relief

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provisions to the practices of the FTB and the IRS. The standard procedure of the FTB is to notify non-claiming spouses of a claim for relief. This procedure is partly based on statute and partly on cases heard before the United States Tax Court (USTC). RTC subdivision 18533(e)(1)(A) requires the FTB to notify nonclaiming filers of a joint return before making a final determination on a claim of innocent spouse. The USTC case *Corson vs. Commissioner* (114 TC No. 24) determined that IRS code section 6015 contemplated providing an opportunity for the participation of a nonclaiming spouse in a claim of innocent spouse. The FTB has taken note of this decision in its administration of its innocent spouse and equitable relief provisions.

Although the Board is not bound by either the IRS or FTB codes or by the standard procedures of the FTB, it was the intent of AB 2898 that the Board's legal provisions and practices conform to those of the IRS and FTB as far as was practical. The adoption of the notification provisions corresponds to that intent.

All proposed amendments to Regulation 1705.1 constitute general applications of section 6456. Under Government Code section 11342.600, the proposed amendments must be in a regulation because they interpret and make specific the provisions of section 6456.

**B. Pros of the Staff Recommendation**

- Establishes administrative procedures for filing and granting claims for equitable relief as required by section 6456(f).
- Clarifies the proper application of provisions in RTC section 6456 and subdivision 1705.1(c) concerning community property laws.
- Brings Regulation 1705.1 into conformity with IRS and FTB provisions for innocent spouse and equitable relief.

**C. Cons of the Staff Recommendation**

Requires regulatory change.

**D. Statutory or Regulatory Change**

No statutory change needed. However, regulation will need to be amended.

**E. Administrative Impact**

Staff will be required to inform taxpayers and staff of the regulatory change.

**F. Fiscal Impact****1. Cost Impact**

No additional cost is anticipated for administering claims for innocent spouse or equitable relief. Administration of these claims is already included in the budget for the Offers in Compromise Section. It is also anticipated that there will be no additional cost for notification of taxpayers. Notice will be accomplished through an article in the Tax Information Bulletin (TIB). Preparation of TIB articles is included in currently budgeted tasks.

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**2. Revenue Impact**

None. See Revenue Estimate, Exhibit 1.

**G. Taxpayer/Customer Impact**

Provides claiming spouses with guidelines for applying for equitable relief and requesting reconsideration of claims that are denied.

**H. Critical Time Frames**

Equitable relief provisions have an effective date of January 1, 2001.

**VI. Alternative 1**

**A. Description of the Alternative**

Do not amend Regulation 1705.1.

**B. Pros of the Alternative**

Does not require statutory or regulatory change.

**C. Cons of the Alternative**

- Regulation 1705.1 will not be in conformity with Sales and Use Tax Law provisions concerning innocent spouse and equitable relief.
- Would not establish administrative procedures for filing and granting claims for equitable relief as required by section 6456(f).
- Would not clarify the proper application of provisions in RTC section 6456 and subdivision 1705.1(c) concerning community property laws.
- Would not bring Regulation 1705.1 into conformity with IRS and FTB provisions for innocent spouse and equitable relief.

**D. Statutory or Regulatory Change**

None.

**E. Administrative Impact**

Administration of innocent spouse and equitable relief claims would be more difficult because of lack of clear regulatory guidelines.

**F. Fiscal Impact**

**1. Cost Impact**

None.

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**2. Revenue Impact**

None. See Revenue Estimate, Exhibit 1.

**G. Taxpayer/Customer Impact**

Lack of regulatory guidance could cause confusion concerning eligibility and filing for innocent spouse and equitable relief.

**H. Critical Time Frames**

None.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: 03/12/01

REVENUE ESTIMATE

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION



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PROPOSED REGULATORY CHANGES CONCERNING THE  
GRANT OF EQUITABLE RELIEF TO A SPOUSE UNDER  
REGULATION 1705.1, *INNOCENT SPOUSE RELIEF FROM  
LIABILITY*

**Staff Recommendation**

To implement Revenue and Taxation Code (RTC) subdivision 6456(f), staff recommends that subdivision (h) be added to Sales and Use Tax Regulation 1705.1 to provide for the conditions and procedures under which a claiming spouse who is denied relief as an innocent spouse may apply for equitable relief. Subdivision has an operative date of January 1, 2001.

Staff recommends that, in conformity with the California Personal Income Tax Law and the federal Internal Revenue Code, language be added to subdivision 1705.1(c) to clarify that an innocent spouse claim may be filed when the claiming spouse is no longer married to, is legally separated from, or is no longer a member of the same household as the nonclaiming spouse. This provision has no operative date.

Staff also recommends that, in conformity with California Personal Income Tax Law, subdivision 1705.1(i) be added to the regulation requiring notification of the non-claiming spouse about a claim for innocent spouse relief or equitable relief and the basis of the claim. This provision has no operative date.

**Alternative 1**

Do not amend Regulation 1705.1.

**Background, Methodology, and Assumptions**

**Staff Recommendation:**

There is nothing in the proposed amendments to Regulation 1705.1 that would impact revenues.

**Revenue Estimate**

**Alternative 1:**

Alternative 1 has no revenue effect.

**Revenue Summary**

The staff recommendation has no revenue effect.

The alternative proposal has no revenue effect.

**Preparation**

This revenue estimate was prepared by David E. Hayes, Research and Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Charlotte Paliani, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of March 12, 2001



## Regulation 1705.1. Innocent Spouse Relief from Liability.

**(a) IN GENERAL.** A spouse claiming relief from liability for any sales or use tax, interest, penalties, and other amounts shall be relieved from such liability where all the following requirements are met:

(1) A liability is incurred under the Sales and Use Tax Law;

(2) The liability is attributable to the nonclaiming spouse;

(3) The spouse claiming relief establishes that he or she did not know of, and that a reasonably prudent person in the claiming spouse's circumstances would not have had reason to know of, the liability; and

(4) It would be inequitable to hold the claiming spouse liable for the liability, taking into account whether the claiming spouse significantly benefited directly or indirectly from the liability, and taking into account all other facts and circumstances.

**(b) DEFINITION OF "BENEFITED."** Whether a claiming spouse has benefited directly or indirectly from the liability will be determined by a review by the Board of all of the available evidence. Normal support payment is not a significant benefit for purposes of this determination. Normal support is measured relative to each family's standard of living. The claiming spouse will not be deemed to have benefited directly or indirectly from the liability solely as a result of normal support unless his or her lifestyle significantly improved during the periods of liability. Gifts received by the claiming spouse, or lavish or luxury purchases made by either spouse may be evidence that the claiming spouse benefited directly or indirectly from the liability. Evidence of direct or indirect benefit may consist of transfers of property, including transfers which may be received several years after the calendar quarter in which the liability occurred. For example, if a claiming spouse receives from the other spouse an inheritance of property or life insurance proceeds which are traceable to the liability, the claiming spouse will be considered to have benefited from that liability. Other factors considered may include desertion of the claiming spouse by the other spouse or that the spouses have become divorced or separated subsequent to the periods of liability.

**(c) ATTRIBUTION.** The determination of the spouse to whom items of liability are attributable shall be made without regard to community property laws.

(1) A claim may be filed if, at the time relief is requested, the claiming spouse is no longer married to or is legally separated from the nonclaiming spouse, or the claiming spouse is no longer a member of the same household as the nonclaiming spouse.

(2) With respect to a liability incurred as a result of a failure to file a return or an omission of an item from the return, attribution to one spouse may be determined by whether a spouse rendered substantial services as a retailer of taxable items related to the liability. If neither spouse rendered substantial services as a retailer, then the attribution of the liability shall be treated as

community property. A liability incurred as a result of an erroneous deduction or credit shall be attributable to the spouse who caused that deduction or credit to be entered on the return.

**(d) WRITTEN REQUEST FOR RELIEF.** To seek relief under these provisions, a claiming spouse may submit a written request for relief setting forth the seller's permit number, the period for which relief is requested, and the specific grounds upon which the request for relief is based.

**(e) STATUTE OF LIMITATIONS.** These provisions shall apply to all calendar quarters for claims made no later than one year after the board's first contact with the spouse making the claim.

Claims made after one year from the board's first contact with the spouse making the claim shall not apply to any calendar quarter that is more than,

Five years from the return due date for nonpayment on a return, or

Five years from the finality date on the board-issued determination,

whichever is later.

No calendar quarters shall be eligible for relief under this regulation that have been closed by res judicata.

**(f) REFUNDS.** A refund of any amounts under these provisions shall be subject to the requirements as set forth in Revenue and Taxation Code sections 6901 through 6908, inclusive.

**(g)** This regulation shall apply retroactively to liabilities arising prior to January 1, 1994.

**(h)** Effective January 1, 2001, a spouse may be relieved of liability for any unpaid tax or deficiency under the Sales and Use Tax Law if, taking into account all the facts and circumstances, it is inequitable to hold the spouse liable for such amount attributable to any item for which relief is not available under subdivisions (a) through (d). A spouse may be considered for equitable relief under this subdivision only after a written claim for relief as an innocent spouse has been filed pursuant to subdivision (d). A spouse whose claim for equitable relief is denied may request that the claim be reconsidered by the Board.

(1) Criteria for Equitable Relief.

(A) Factors that may be considered for the purpose of granting equitable relief include, but are not limited to:

1. The claiming spouse is separated (whether legally or not) or divorced from the nonclaiming spouse.

2. The claiming spouse would suffer economic hardship if relief is not granted.

3. The claiming spouse, under duress from the nonclaiming spouse, did not pay the liability. To substantiate "duress," the claiming spouse must provide objective evidence. "Objective

evidence” can include, but is not limited to, such documents as police reports, restraining orders, or counseling reports.

4. The claiming spouse did not know and had no reason to know about the items causing the understatement or that the tax would not be paid.

5. The nonclaiming spouse has a legal obligation under a divorce decree or agreement to pay the tax. (This obligation will **not** be considered a positive factor if the claiming spouse knew or had reason to know, at the time the divorce decree or agreement was entered into, that the nonclaiming spouse would not pay the tax.)

6. The tax for which the claiming spouse is requesting relief is attributable to the nonclaiming spouse.

**(B)** Factors that may be considered for purposes of denying equitable relief include, but are not limited to:

1. The claiming spouse will not suffer economic hardship if relief is not granted.

2. The claiming spouse knew or had reason to know about the items causing the understatement or that the tax would be unpaid at the time the claiming spouse signed the return.

3. The claiming spouse received a significant benefit from the unpaid tax or items causing the understatement.

4. The claiming spouse has not made a good faith effort to comply with the Board’s laws for the periods for which the claiming spouse is requesting relief or for subsequent periods of liability.

5. The claiming spouse has a legal obligation under a divorce decree or agreement to pay the tax.

6. The tax for which relief is being requested is attributable to the claiming spouse.

(2) Conditions for Relief. The following conditions apply to claims for equitable relief:

**(A)** The statutes of limitations provided for innocent spouse claims in subdivisions 1705.1(e) and (f) also apply to requests for equitable relief.

**(B)** Claims for equitable relief are not limited to liabilities incurred after the effective date of January 1, 2001, but are allowed the same retroactivity as granted in subdivision (g) for a claim as innocent spouse.

**(i)** Notification of the claim for relief from liability and the basis for that claim shall be sent to the nonclaiming spouse.

**Revenue and Taxation Code Section 6456**  
**As Amended by AB 2898 (Chap. 1052) Stats. of 2000**

SECTION 1. Section 6456 of the Revenue and Taxation Code is amended to read:

6456. (a) Under regulations prescribed by the board, if:

(1) A tax liability under this part was understated by a failure to file a return required to be filed under this part, by the omission of an amount properly includable therein, or by erroneous deductions or credits claimed on a return, and the understatement of tax liability is attributable to one spouse; or any amount of the tax reported on a return was unpaid and the nonpayment of the reported tax liability is attributable to one spouse,

(2) The other spouse establishes that he or she did not know of, and had no reason to know of, that understatement or nonpayment, and

(3) Taking into account whether or not the other spouse significantly benefited directly or indirectly from the understatement or the nonpayment and taking into account all other facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax attributable to that understatement or nonpayment, then the other spouse shall be relieved of liability for tax (including interest, penalties, and other amounts) to the extent that the liability is attributable to that understatement or nonpayment of tax.

(b) For purposes of this section, the determination of the spouse to whom items of understatement or nonpayment are attributable shall be made without regard to community property laws.

(c) This section shall apply to all calendar quarters subject to the provisions of this part, but shall not apply to any calendar quarter that is more than five years from the final date on the board-issued determination, five years from the return due date for nonpayment on a return, or one year from the first contact with the spouse making a claim under this section; or that has been closed by res judicata, whichever is later.

(d) For purposes of paragraph (2) of subdivision (a), "reason to know" means whether or not a reasonably prudent person would have had reason to know of the understatement or nonpayment.

(e) For purposes of this section, with respect to a failure to file a return or an omission of an item from the return, "attributable to one spouse" may be determined by whether a spouse rendered substantial service as a retailer of taxable items to which the understatement is attributable. If neither spouse rendered substantial services as a retailer, then the attribution of applicable items of understatement shall be treated as community property. An erroneous deduction or credit shall be attributable to the spouse who caused that deduction or credit to be entered on the return.

(f) Under procedures prescribed by the board, if, taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for any unpaid tax or any deficiency (or any portion of either) attributable to any item for which relief is not available under subdivision (a), the board may relieve the other spouse of that liability.